



**OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT**  
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June 14, 2002

Honorable Christopher Shays  
U.S. House of Representatives  
1126 Longworth HOB  
Washington, DC 20015

Honorable Edward J. Markey  
U.S. House of Representatives  
2108 Rayburn HOB  
Washington, DC 20015

Dear Congressmen Shays and Markey:

Thank you for your letter of May 24, 2002, concerning OFHEO's review of the financial disclosures provided by Fannie Mae and Freddie Mac (the Enterprises). I am happy to have this opportunity to describe the work of OFHEO in financial disclosure and our plans for the future.

#### **Overview of the Disclosure Project**

As the Enterprises' safety and soundness regulator, OFHEO has the authority and responsibility to ensure that their disclosures are adequate to promote meaningful market discipline. I agree with the Basle Committee on Bank Supervision that market discipline is one of the three pillars of effective safety and soundness regulation. Furthermore, market discipline can only be effective when there is sufficient transparency and disclosure.

Disclosure also provides important investor protections that are essential to maintenance of the Enterprises' continued access to funds on favorable terms. For these reasons, disclosure is an important part of ensuring the financial health of the Enterprises and thus part of OFHEO's regulatory program.

The Enterprises recognize the importance of transparency and investor protection to their financial health through the substantial voluntary disclosures they already provide to the investment community. Fannie Mae's decision to reverse its clean-up call on its mortgage-backed securities illustrates how important it is to the Enterprises' credibility and financial health that investors regard the companies' disclosures as adequate.

Accordingly, OFHEO has initiated a review of the adequacy of the Enterprises disclosures, and not just whether they are identical to those of other publicly-held companies. OFHEO expects to complete this review in August.

#### **Legal Authority**

OFHEO possesses both explicit and implied supervisory authority that may be employed to review the adequacy of disclosures by the Enterprises. This authority is essentially similar to that

of the other safety and soundness regulators. In particular, there exists ample authority to issue rules on a broad range of supervisory matters, to oversee and examine the Enterprises and to secure information and reports from them; 12 U.S.C. 4513 (a). In addition, 12 U.S.C. 4514 authorizes OFHEO to require reports from the Enterprises and 12 U.S.C. 4501 (6) expresses Congressional intent that OFHEO address financial disclosures.

### **Staff Resources**

OFHEO staff is well qualified to review disclosures and implement any regulatory actions determined to be necessary. The disclosure review is being managed by the Office of General Counsel and draws upon the entire resources of the Agency. Current legal expertise includes knowledge of SEC registration statements and periodic reports and reporting requirements, and the relationship of bank regulators with the SEC. Significant additional staff resources include expertise in investment banking, financial analysis, securities market structure and National Market System developments, institutional research, and importantly, public accounting.

It should also be remembered that no government agency has more expertise regarding the Enterprises themselves than does OFHEO. Our unique view of these complex businesses comes as a result of the day-to-day work of examining the Enterprises and doing research on their operations. With this expertise and insight, OFHEO is well positioned to ensure that disclosures are appropriate and meaningful and meet required standards of "materiality" as applied to two government sponsored enterprises.

In terms of our work and its impact on the relationship with SEC enforcement, I would only point out that bank holding companies are regulated by the SEC and by the Federal Reserve, and that the attorneys at OFHEO are familiar, not only with direct compliance with SEC rules, but also with an environment where bank regulators address securities disclosure in tandem with the SEC.

### **Conflicts**

The exercise of both disclosure oversight and safety and soundness responsibilities by OFHEO entails no conflicts. Indeed, as has been previously mentioned, disclosure is an integral part of safety and soundness regulation.

Regarding the examples stated in your letter, loan loss provisioning is not a major issue with respect to the Enterprises because loan loss reserves are small relative to their income. Additionally, the Enterprises conform to FAS 133 and that compliance is the subject of OFHEO oversight. OFHEO's capital standards conform to GAAP except where Congress by statute has directed otherwise.

06/14/02

Page 3

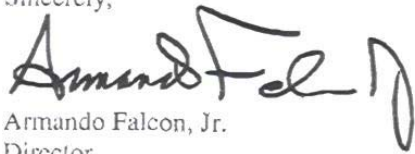
### **Enforcement**

OFHEO has a full panoply of supervisory tools at its disposal, and the legal and regulatory framework already exists to accommodate agency action. Those tools range from informal communications, letters, written agreements, targeted review of Enterprise operations, guidances, rulemaking proceedings, cease and desist and civil money penalties.

Further, the Enterprises are not exempt, just as banks are not exempt, from the antifraud provisions of the federal securities laws. OFHEO has primary authority to act to remedy violations of the Enterprise charters or any action that threatens safe and sound operations. OFHEO's enforcement rule at 12 CFR 1780 addresses the agency's broad enforcement tools and legal authorities.

I am pleased to respond to the issues raised in your letter. If you or your staff have any questions about OFHEO or the important work that the Agency is doing, please let me know.

Sincerely,

A handwritten signature in black ink, appearing to read "Armando Falcon, Jr.", with a stylized flourish at the end.

Armando Falcon, Jr.  
Director